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KEY ECONOMIC INDICATORS - NEPAL
(in millions of U.S. dollars)

(Nepal FY begins mid-July)	FY87/88	FY88/89	FY89/90/1	FY90/91/2
Domestic Economy				
Population (millions)	17.9	18.4	18.9	19.4
population growth (percent)	2.66	2.66	2.66	2.66
GDP in current dollars	3,160	3,024	2,978	3,082
GNP in current dollars	3,231	3,091	3,044/2	3,151
Real SDP growth rate/3	7.83	2.31	2.01	3.5
Consumer Price Index (percent change)	11.0	8.1	11.5	8.0
Production and Employment				
Nonagriculture labor force (1981 Census - thousands)	591			
Industrial output index (FY74/75 = 100)	327.8	320.7	277.6	290.0
Cash crop production index (FY74/75 = 100)	223.0	248.7	262.8	278.0
Government				
Government expenditures,	641.1	703.3	654.7	618.5
Government revenue	334.1	303.8	316.9	316.5
Receipt of foreign loans/grants	267.8	287.0	276.4	250.7
Balance of Payments				
Exports (F.O.B.)	187.1	164.9	176.0	200.0
Imports (C.I.F.)	629.9	638.3	630.4	70.0
Trade balance	-442.8	-473.4	-454.4	-470.0
Current account balance	-267.6	-296.4	-308.1	-365.9
External disbursed debt outstanding (end CY)	919.2	1,091.5	1,289.0	1,515.3
Debt service as percent of all exports	7.9	9.1	12.7	12.0
Debt service as percent of GDP	1.2	1.4	1.9	1.9
International reserves (months of import cover)	4.9	4.8	6.0	5.4
Average exchange rate for year (NRs per US$1.00)	22.06	25.53	28.52	32.00
U.S.-Nepal Trade and Aid				
U.S. exports to Nepal/4	7.5	6.4	n.a.	n.a.
U.S. imports from Nepal/5	42.0	45.8	47.4/2	n.a.
U.S. share of Nepal exports (percent)	21.9	27.9	27.1/2	n.a.
U.S. share of Nepal imports (percent)	1.2	1.0	n.a.	n.a.
U.S. economic aid (U.S. FY)	11.7	15.3	16.9	16.5

1 FY 89/90 data are revised estimates.
2 FY 1990/91 data, and some 1989/90 data, are projections by the World Bank and Nepal's National Planning Commission.
3 Percent change in 1987 NRs.
4 Principal U.S. exports to Nepal: medicine, machinery and spare parts, milk products. There are other U.S. exports, but Nepal imports them via a third country and they are counted as imports from that country (for example, U.S. goods purchased from Singapore).
5 Principal U.S. imports from Nepal: ready-made garments, carpets, niger seeds, and silverware.

Sources: Nepal Economic Survey FY89/90; IBRD, IMF, USAID and Rastra (Central) Bank reports.

SUMMARY

Nepal is a small landlocked country situated on the lap of the Himalayas. Geographically, it is divided into three horizontal regions -- Terai (plains), hills and mountains. This regional breakdown reflects the ecological diversity of the country. Over 90 percent of the 19.4 million population are subsistence farmers. The average per capita income is $170, but that figure drops to $20 in remote mountain areas and rises to $500 in urban centers like Kathmandu. According to government statistics, 8 million people live below the poverty level of $100 per capita.

Difficult terrain and limited accessibility along the northern border with China, easy accessibility in the south along the 500 mile open border with India, and the lack of a seaport all influence Nepal's foreign economic relations. Nepal is rich in water resources with a hydroelectric potential of 83,000 megawatts, less than 1 percent of which is developed. In recent years, foreign donors have committed over $450 million per year in economic assistance.

During the early 1980s, the growth of the value of production in Nepal (real GDP) averaged 4 percent per year and approached 5 percent in the late 1980s. In spite of the dislocations caused by the trade and transit dispute with India, economic growth was still 2.3 percent in 1988/89 and 2 percent in 1989/90. The World Bank forecasts that continued growth in agricultural production and improved exports to India will result in 3.5 percent real growth in 1990/91 and 4.5 percent in 1991/92.

Merchandise imports far exceed exports and the gap has been growing. Unrecorded, informal exports to India lessen the significance of the trade deficit. Service transactions (tourism and remittances of Nepalese working outside Nepal) and foreign loans and grants also finance the deficit.

After the success of the movement for multiparty democracy in April 1990, the interim government in June concluded a memorandum on trade and transit with India. This document restored normal trading relations with India until a new government can renegotiate the treaties in 1991. Increased tariff concessions to India ought to increase imports from India, while decreased tariffs on some Nepalese exports could improve the potential for industrial development in Nepal. Before the Indo-Nepal dispute, India purchased around one-third of Nepal's merchandise exports, and supplied a slightly higher percentage of Nepal's imports. While Nepal has reduced its dependence on India, further diversification will be difficult.

CURRENT ECONOMIC SITUATION AND TRENDS

Nepal is sandwiched between two major economic powers, India and China. Both countries believe government should intervene in the economy and both impose extensive controls on business activity. The flat Gangetic Plain which forms the border with India is not a natural barrier. Goods and people flow freely in both directions based on where wages or prices are higher. Thus, prices in Nepal must approximate those in India. Nepal cannot have a significantly different economic policy from India so long as relatively unfettered movement continues.

The Interim Government took office in April 1990 with a mandate to formulate a new constitution and hold elections within a year. It is a coalition of the Nepali Congress (a democratic socialist party along the lines of India's Congress party) and the United Left Front (ULF). The ULF is a coalition of seven factions of the Nepal communist party. Some of these factions are changing their economic views to reflect changes in the communist movement elsewhere. A new constitution making Nepal a constitutional monarchy and parliamentary democracy entered into effect in November 1990.

Macro-Economic: In 1988/89 and 1989/90, economic activities were greatly influenced by the 15 month trade and transit dispute with India which began on March 23, 1989. The dispute resulted in India cutting off Nepal's preferential access to the Indian market, its refusal to sell Nepal certain basic raw materials like petroleum products and coal, and its restriction of transit rights. Even so, Nepal's economic performance, though poor in comparison to past years, was better than expected. The value of domestic production (real GDP) grew by 2.3 percent in 1988/89, not the 1.5 percent decline which had been forecast. Agricultural production grew by 3.3 percent, the result of good rains and of major crops having been harvested prior to the dispute. Decreased sales of primary products to India reduced the incomes of many farmers. In 1989/90, total economic growth continued to be positive, but below the previous year: 2 percent.

Nepal's real income per capita measured in U.S. dollars declined because population growth rose by 2.7 percent and because the value of the Nepalese rupee has been declining.

Both the government and the World Bank forecast a growth in domestic production of 3.5 percent for 1990/91 due to a projected excellent agricultural crop and increased sales of primary products to India.

Inflation was a relatively low 11.5 percent in 1989/90 during the trade/transit dispute, which was good considering the fears that the dispute would lead to inflation of over 30 percent. Domestic money supply during the first nine months of the 1989/90 Nepalese fiscal year grew by 15 percent as against a 13 percent target for the year. As part of the structural adjustment program, the government did strive to increase domestic revenue and constrain borrowing: domestic credit increased only 4 percent, but government borrowing exceeded targets. Because of the porosity of Nepal's border with India, inflation cannot differ much from India's for those goods that can be traded across the border.

When the new government came to power and resolved the dispute with India, it announced that prices of goods would decrease by 30-35 percent. Some prices fell with the reduction of import duties on Indian goods. Since then prices have begun to rise in line with Indian inflation. The government forced down the prices for some price-controlled items like sugar, kerosene and diesel. It has also tried to pressure merchants to reduce prices.

Trade and Balance of Payments: In the year prior to the trade and transit dispute (1987/88), India's share of Nepali exports was 38 percent. This fell to 25 percent in 1988/89 and 9 percent in 1989/90. India's share of imports has been falling and was 25 percent in 1989/90. Nepal's trade deficit with India still accounts for nearly one-third of Nepal's total trade deficit.

To promote exports, the Government of Nepal provided export incentives of between 5 and 35 percent for 11 items formerly exported to India. Even with government subsidies, these products still could not find markets, thus leading the Government of Nepal to conclude that the items are dependent on the Indian market: Nepal cannot afford an independent trade policy.

The Interim Government settled the dispute with India on a temporary basis. It did not negotiate new treaties but permitted the previous trade and transit treaties to continue in force, with minor changes, until the new government comes to power following scheduled spring 1991 elections. The changes relate to reduced tariffs on Indian high-dutied goods and increased access to India for Nepalese manufactured items.

With the restoration of normal trading relations with India, Nepal's exports are expected to grow by over 20 percent in the coming fiscal year. For overseas countries, Nepal is dependent on two major items which accounted for 89 percent

of the value of exports last year: carpets and ready-made garments. Almost all carpets go to Western Europe (Germany and Switzerland) and nearly all garments go to the United States. Because of this narrow base, Nepal's export situation is vulnerable to price and demand changes elsewhere. Tibetan-style carpets made in China and India are cheaper in those countries than in Nepal, but Nepal has an advantage in quality and market responsiveness. Nepal is a high cost producer of ready-made garments. Production takes place when other South Asian counties have fulfilled their quotas.

Tourism presently accounts for 24 percent of Nepal's foreign exchange earnings and 60 percent of export earnings.

Government Spending and Revenue: In rupee terms, expenditures in the 1990/91 budget increased 6 percent: regular expenditures by 10 percent and development expenditures by 4 percent. The budget had to accommodate an increase of nearly 30 percent in public employee wages, demands for price relief, and projected costs of national elections. Thus, the development budget is constrained, and the government has indicated that it will be difficult to meet the demands of donor-funded activities and still stay within structural adjustment limits.

On the fiscal side, government revenues in 1989/90 showed a 4.7 percent increase in dollar terms over 1988/89. Foreign loans and grants, however, decreased 3.7 percent. Domestic revenue contributed 51 percent to total revenue, foreign loans (all concessional) 28 percent, and foreign grants 13 percent. The balance came from domestic borrowing and drawing down cash balances.

Industry: The government's decisions on higher minimum wages, increased government salaries, forced price reduction on some price-controlled goods, and the proposed introduction of a wealth tax have sent negative signals to private business. Government blames the previous system for poor economic growth due to ill-advised policies, improper selection of projects, and corruption.

The present government seeks to improve economic performance through a mixed economy, with a balance between self interest and social responsibility. It may try to make state enterprises operate in a more commercial manner with greater management autonomy, as well as through partial privatization of ownership through sales of equity to private enterprises, the general public, and workers.

The uncertain stance of government towards the private sector has led some businessmen to defer investment plans until after the elections. Overall investment has increased because the end of the trade disagreement with India improved supplies of needed raw materials and led to the export of primary as well as light industrial products.

The government plans to review the Industrial Policy of 1987 that allows large enterprises to be fully foreign owned if exports are 90 percent of production. A medium-scale enterprise (fixed capital of $94,000-$312,000) can have foreign ownership of up to 50 percent. At present, foreign investment is low and primarily Indian. This is because Nepal's preferential trading regime is heavily biased towards India, requiring fewer licenses, approvals, and foreign exchange permits for purchases from India. Complicated rules and regulations, a difficult approval process, and the lack of effective incentives have all contributed to limited foreign investment. One net result is a strong incentive for Indians to sell in Nepal but little incentive to produce in Nepal.

Most of Nepal's factories engage in small-scale food processing (rice, wheat, and oil mills) using simple technology. Larger factories are frequently government owned. The dispute with India and resulting shortages of raw materials, petroleum, coal, and spare parts reduced the industrial production index from 321 in 1988/89 to 277 in 1989/89. Still, the production of cigarettes, liquor, soap, beer, textiles, and biscuits increased.

Tourism is a major source of foreign exchange and receives high priority from the government, including import duty and company tax concessions. There is potential for further development of environmentally sensitive tourism. The lack of price competitiveness which bedevils carpet and garment exports is less of a worry for tourism because of Nepal's uniqueness.

Labor: The success of the democracy movement led to the legalization of trade unions with nearly all parties and factions establishing separate unions. The major areas of disagreement between unions and management were salaries, benefits, and job permanency. Most labor issues remain unsolved in late 1990.

Labor disputes were less frequent in late 1990 than during the April-August period because the government increased the minimum wage, unemployment was up, and union organizers feared the negative impact strikes might having on future political success. The continued politicization of labor may have a negative impact on investment since some decisions affecting labor could be subject to political pressure.

IMPLICATIONS FOR THE UNITED STATES

Currently, the U.S. share of Nepal's imports is only 1 percent, of which a significant portion is development goods financed by international donors. Actual purchase of U.S. goods is higher, but because they are imported from Hong Kong or Singapore they are not listed as American.

Nepal's future development will continue to rely on capital-intensive projects. Supplying U.S. goods and providing United States contracting and consultancy services for development projects present significant opportunities for American business people. There is scope for supplying construction materials, telecommunication equipment, hydroelectric equipment, insecticides, medicines, and machinery and parts for which the United States has a comparative advantage. The larger projects (financed by the Asian Development Bank and the World Bank Group) are advertised and are decided through global bidding. In recent years, the market for development projects has been $100-$200 million per year. A major World Bank-funded construction project to be bid in 1991, the Arun III hydroelectric plant, is projected to cost $1 billion over the span of the next decade.

Important U.S. exports to Nepal include aircraft spare parts, milk powder, wheat, soybean milk, and almonds. A growing Nepalese urban population will increase demand for bathroom fittings, household appliances, electronics, fine textiles, fancy foods, and toiletries. To minimize risk in the initial stages, new commercial ventures could be handled through Nepalese sales agents or offshore (Bangkok or Singapore) agents or brokers who service other Asian markets.

The U.S. share in Nepal's exports is 28 percent, which includes items like ready-made garments, carpets, silverware, jewelry and niger seed (bird seed). The United States is the major buyer of Nepal's ready-made garments, accounting for 96 percent of total sales. Under a recently renegotiated agreement, garment sales to the United States in 1988/89 were valued at $41.9 million. Current U.S. investment in Nepal is small, but opportunities exist in ready-made garments, carpets, jewelry, leather goods, and forest-based export industries. Foreign investors in sectors other than tourism are likely to have problems because of the small domestic market. Tourism is doing well and could be strengthened through more charter flights and improved marketing.

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